

**ProCredit Bank (Bulgaria) EAD**

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**DISCLOSURE OF INFORMATION AS PER PART EIGHT OF EU REGULATION No. 575/2013 OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL of 26 June 2013 on the prudential requirements for credit institutions and investment firms and amending EU Regulation No 648/2012**

**Data are on an individual basis as of 31.12.2014.**

**This English translation is provided by ProCredit Bank for information only, and is not legally valid. The Bulgarian version is the only legally binding version.**

**All amounts are in BGN thousands**

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## **I. Aims and scope**

### **1.1. Introduction**

ProCredit Bank Bulgaria was founded in October 2001 by an alliance of international development-oriented investors, many of which are shareholders in ProCredit Holding AG & Co. KGaA („ProCredit Holding”) today. Since the beginning of 2013 the sole shareholder of the Bank is ProCredit Holding.

ProCredit Holding is the parent company of a global group of ProCredit banks. At the end of 2014 the group comprises 19 banks, operating in Germany, Eastern Europe, Latin America and Africa. At group level, ProCredit is subject to supervision by the German federal supervisors - BaFin (Bundesanstalt für Finanzdienstleistungsaufsicht, the German Federal Financial Supervisory Authority) and the Deutsche Bundesbank (central bank of the Federal Republic of Germany).

ProCredit Holding AG & Co. KGaA is the parent company of the group, controlling the majority of shares in all ProCredit institutions worldwide. The main functions of ProCredit Holding vis-à-vis its subsidiaries are the provision of equity and debt financing, strategic guidance and supervision. It sets the overall policy guidelines and standards regarding all key areas of banking operations. ProCredit Holding is responsible for ensuring that all ProCredit institutions have appropriate organisational structures and procedures in place that reflect these policies, and that they apply appropriate standards for risk management and the prevention of money laundering, fraud and the financing of terrorism.

ProCredit Holding is strongly involved in staff management and training issues. It takes the lead in the development and delivery of curricula in the central ProCredit Academy in Fürth, Germany, and the group’s Regional Academies. It also facilitates the rapid dissemination of best-practice approaches by running regular seminars and workshops for the senior middle managers of all ProCredit institutions.

According to the rating agency Fitch, the investment rating of ProCredit Holding is BBB (last review on 09.02.2015).

### **1.2. Aims of the information disclosure**

With the present report ProCredit Bank responds to the requirements for disclosure of information as of 31.12.2014 in accordance with Art. 70 (3) of the Law on credit institutions and Part Eight of Regulation 575/2013 of the European Parliament and of the Council (Regulation 575/2013). The sufficiency of the reported disclosures is reviewed annually by the Bank. Confidential information or that which is legally protected or its publication would weaken the competitive position of the Bank is not subject to presentation in these disclosures. The information disclosed is based on audited financial statements as of 31.12.2014.

### **1.3. Scope of consolidation**

This report is prepared on an individual basis. It was approved by the Management Board of the Bank on 10 June 2015.

## II. Risk management

### 2.1. Business model and business strategy

ProCredit Bank aims at being a leading partner providing a complete range of financial services for small and medium enterprises in Bulgaria, since these businesses have vital significance for the economic development and the creation of new jobs.

The bank functions in a responsible and transparent way, focusing on building long-term relationships with its clients and providing an inclusive range of professional and flexible business solutions, both for the businesses and for their owners and staff. The main competitive advantages of ProCredit Bank are the personal approach to the individual needs of the clients and the high quality of the services provided.

By offering simple and accessible deposit facilities the Bank promotes a culture of savings, which contributes to greater security and stability of households. At the same time ProCredit Bank does not offer complex financial products or asset management services.

ProCredit Bank takes an individual approach to its clients, aiming to know their needs in order to develop a strategy for serving them effectively. The Bank adheres to its concept of “Know your Customer”, which is based on the assumption that if clients and their businesses are accurately identified, the Bank will be able to provide them with the most suitable banking services. A strategic focus of the work with clients is on funding projects leading to improving energy efficiency and environmental protection as well as funding production companies and agricultural producers. To achieve more efficient, effective and better-quality service, the Bank provides 24-hour access to self-service areas.

The ProCredit Bank business strategy has two main purposes – to have a positive effect on the development of the economic and social environment, and to earn a commercial profit. The business model is straightforward, with asset-side operations dominated by credit issued to clients, while the liabilities basically comprise retail deposits.

The business strategy is based on a focused approach to staff development. The Bank carefully recruits and trains its staff to work responsibly and professionally with clients. ProCredit Bank is an institution based on professionalism, communication and trust and it aims at a high level of satisfaction both for the staff and the clients. To this effect, the Bank makes significant investments in training its personnel.

### 2.2. Risk management strategy

The Bank’s risk management strategy is conservative, and is thus in line with its simple, transparent and sustainable business strategy. Only risks arising from its core activity are taken – servicing small and medium enterprises. The purpose of risk management is to have all risks adequately identified, assessed and covered by capital.

#### i. Focus on core business

ProCredit Bank is focused on providing financial services to small and medium enterprises and households. Basically, the Bank’s revenue consists of interest income generated from loans disbursed to clients and income from fees and charges for bank operations. In its daily operations, the Bank is mainly exposed to credit and operational risks.

## ii. High degree of transparency, simplicity and diversification

The focus on small and medium enterprises results in a high degree of diversification, both in the credit portfolio and in the deposit base. This is achieved on the levels of client groups, business sectors and avoidance of concentration. The simple and easily understandable products both aid transparency and facilitate risk management.

## iii. Careful staff selection and intensive training

Responsible banking means long-term relationships not only with clients, but with the employees of the Bank. The basic elements of the personnel management approach at the Bank are: recruitment, involving a six-month intensive training programme for all candidates (the Young Bankers Programme), regular trainings for current employees, intensive managerial training at the ProCredit Academies and applying a universal remuneration structure across the ProCredit group, based on fixed monthly salaries.

### 2.3. Organization and reporting in regards to risk management

ProCredit Bank adheres to the risk policies of ProCredit Holding, applicable to all banks within the ProCredit group. Locally, the Management Board, supported by the Risk Committees, defines the risk tolerance margins, taking into consideration the regulatory requirements of the Bulgarian National Bank and the situation in the country.

The overall internal control of the Bank is carried out by the Supervisory Board and the Management Board. The Supervisory Board controls the activity of the Management Board. The Management Board controls the separate structural units. The Bank has a comprehensive internal control system, as well as an independent Internal Audit Department. The Bank's activities follow internal rules and procedures along with the current laws.

ProCredit Bank adopts a conservative risk policy, thus adhering to strict control rules for all its processes and activities on both operational and strategic planning levels. The control of risks is exercised currently by the responsible departments and, regularly, by the Risk Committees. Information on the exposure to the various risks of the group is submitted to ProCredit Holding and the Supervisory Board of the Bank.

The rules regulating risk management at the Bank are part of the Internal Regulations and determine:

- The process and the purposes of risk management at the Bank;
- The structure, composition and powers of the competent internal bodies of the Bank, their activities and the measures they undertake;
- The employees' duties related to monitoring, reporting, management and analysis of various risks;
- The establishment and functioning of internal control systems and the competences of the relevant management levels and of the regular staff for taking part in risk management.

Overall responsibility for risk management is borne by the Management Board of the Bank. In their activity they are supported by committees for managing the respective risks:

- Assets and Liabilities Management Committee (ALCO);
- General Risk Assessment Committee;
- Operational Risk Assessment Committee;
- Credit Committee on Restructuring;
- Court Receivables Committee.

The risk management function is actively supported by Finance and Risk management Departments.

#### 2.4. Main Risks

The risks identified with the activity of the Bank are:

- **Credit risk:** The Bank has set up a comprehensive system for assessing and managing credit risk, which starts with the process of granting the loan and ends with its repayment. The Bank allocates provisions which adequately cover the level of credit risk taken. Exposure to concentrations in the loan portfolio is monitored and analysed in order to minimize them.
- **Counterparty risk:** The Bank has a system for exercising prevention and follow-up control on the risk associated with counterparty banks, which is based on preliminarily approved limits and on verification of their implementation prior to signing each agreement.
- **Market risk:** The Bank has adopted an extremely conservative policy in respect to market risks – it does not support a trading portfolio and does not conclude speculative transactions. Thus, its market risk exposure can be judged as insignificant.
- **FX risk:** ProCredit Bank has a minimal FX risk exposure, since it does not form FX positions for speculative purposes and minimizes its open currency positions.
- **Interest rate risk in the Bank's portfolio:** ProCredit Bank manages and keeps the interest rate risk down to an acceptable level by striving to maintain a balanced structure of interest-sensitive assets and liabilities in each time bucket.
- **Liquidity risk:** The Bank mitigates liquidity risk by maintaining an acceptable balance between the level of risk incurred and the profit to be earned from its operations. When managing liquidity, the Bank aims at ensuring that the liabilities structure matches the asset structure, so that at any time the expected outflow of resources can be covered by inflows.
- **Operational risk:** The Bank minimizes its exposure to operational risk through implementation of measures to control the procedures and rules for every single activity. To reduce possible operational losses, the Bank has signed insurance agreements with leading international insurance companies.

- **Legal and reputational risk:** ProCredit Bank manages its exposure to legal and reputational risk by adhering to a policy of transparency in its attitude to all counterparties, by continuity in its business strategies and by its personnel management.

### III. Capital requirements

#### 3.1. Capital management

At no point may ProCredit Bank incur greater risks than it is able to bear. This principle is implemented using different indicators for which early warning indicators and limits have been established. The indicators for each individual ProCredit bank and the group as a whole include, in addition to local regulatory standards, a Basel II capital adequacy calculation, a Tier 1 leverage ratio and a risk-bearing capacity calculation.

At no point may the size of the risk taken by ProCredit Bank exceed the size of the capital available to cover that risk. This principle is implemented using different indicators for which early warning triggers and limits have been established. The triggers are:

- capital adequacy indicators as per the applicable regulations;
- leverage (the ratio between assets and equity of the Bank);
- the risk-bearing capacity calculation.

The purpose of capital management is to guarantee at all times the following:

- the minimum requirements for Tier I capital adequacy and total capital adequacy, as laid down in Regulation 575/2013 of the European Parliament and the Council;
- the minimum requirements for Tier I capital adequacy and the total capital adequacy ratio set under the applicable group policies;
- the capital requirements calculated according to the methodology for Internal Capital Adequacy Assessment Process (“ICAAP”).

Capital management is also regulated by ProCredit group policies via monitoring carried out on a monthly basis. The following factors are taken into consideration in capital management:

- current state and projected dynamics of risk-weighted assets;
- results of ICAAP;
- realized and planned net profit.

The sources of the Bank’s capital are the contributions from the sole shareholder, ProCredit Holding, and part of the profit generated from business activity, in the form of reserves. The Bank forms a reserve fund and other funds and reserves as defined by the current legislation. In accordance with the By-Laws of the Bank for the formation of a reserve fund no less than 10% of the profit after taxation and before paying dividends is allocated until the fund reaches 10% of the capital.

The Bank’s practice is to distribute dividends each year, in an amount equal to the profit from the previous year, minus the amount of the corresponding deductions for the reserve fund. Distribution of dividends is done according to the Recommendations of the National Bank to the banks, applicable as per the year of payment.

Being aware of the significance of Common Equity Tier 1, the Bank plans growth of risk-weighted assets to be accompanied solely by an increase in the share capital and the

reserves. There are no plans to attract debt meeting the requirements for inclusion in Tier 2 capital.

### 3.2. Structure of capital

The regulatory capital is almost entirely composed of common equity Tier 1 capital in accordance with Part II of Regulation 575/2013. The calculation of the capital base of the Bank is shown in detail below:

**Table 1: Capital**

<i>BGN thousands</i>	<i>31-12-2014</i>
<b>Capital components</b>	<b>Value</b>
<b>Tier 1 capital</b>	<b>145,558</b>
<b>Common Equity Tier 1 capital</b>	<b>145,558</b>
Paid-up capital instruments	135,634
Premium reserves	3,496
Other reserves	10,416
(-) Gross amount of other intangible assets	(3,569)
(-) Deductions from Common Equity Tier 1 - investments in subsidiaries	(419)
<b>Additional Tier 1 capital</b>	-
<b>Tier 2 capital</b>	<b>1,277</b>
Paid-up capital instruments and subordinated loans	1,277
<b>Total capital</b>	<b>146,835</b>

Capital (hybrid) instruments were repaid to ProCredit Holding in 2014 in the amount of BGN 48,896 thousand, which by 31.12.2013 had been part of the Tier 2 capital. The amount of BGN 9,779 thousand was reinvested by ProCredit Holding in the form of share capital (Common Equity Tier 1).

The basic characteristics of the capital components are:

- **Common Equity Tier 1 capital**
  - Paid-up capital instruments – totally comprised of paid-up share capital.
  - Premium reserves – the excess of the paid issue value of share capital over its face value.
  - Other reserves – formed by legally defined deductions from generated net profit for the previous reporting periods.
- **Tier 2 capital** – comprises obligations under subordinated debt with an effective maturity date of 25.10.2015.

The following table presents reconciliation of components of the regulatory capital against the annual audited financial statements of the Bank as of 31.12.2014:

**Table 2: Reconciliation of the regulatory capital and audited financial statements**

<i>BGN thousand</i>	
<b>Reconciliation of the regulatory capital and accounting capital</b>	<b>31-12-2014</b>
<b>Total shareholders' equity per accounting balance sheet (accounting capital)</b>	<b>173,089</b>
Retained earnings	(24,417)
Accumulated other comprehensive income, net of tax	874
<b>Total shareholders' equity per regulatory balance sheet</b>	<b>149,546</b>
<b>Common Equity Tier 1 capital before regulatory adjustments</b>	<b>149,546</b>
<b>Regulatory adjustments</b>	<b>(3,988)</b>
Intangible assets	(3,569)
CET1 capital elements or deductions – investments in subsidiaries	(419)
<b>Common Equity Tier 1 capital</b>	<b>145,558</b>
<b>Additional Tier 1 capital</b>	<b>-</b>
<b>Tier 1 capital</b>	<b>145,558</b>
<b>Tier 2 capital</b>	<b>1,277</b>
Subordinated debt as per balance sheet	7,823
Amortization according to Art. 64 of Regulation 575/2013	(6,546)
<b>Total Regulatory capital</b>	<b>146,835</b>

The main features of the paid-in capital of the Bank are as follows:

**Table 3: Main features of the paid-in capital**

<b>Capital instruments main features template</b>		
	<b>Position</b>	<b>Pertinent information</b>
1	Issuer	ProCredit Bank (Bulgaria) EAD
2	Unique identifier (e.g. CUSIP, ISIN or Bloomberg identifier for private placement)	N/A
3	Governing law(s) of the instrument	Bulgarian
<b>Regulatory treatment</b>		
4	Transitional CRR rules	Common Equity Tier 1
5	Post-transitional CRR rules	Common Equity Tier 1
6	Eligible at solo/(sub-)consolidated/ solo&(sub-)consolidated	Solo and (Sub-)Consolidated
7	Instrument type (types to be specified by each jurisdiction)	Ordinary shares
8	Amount recognised in regulatory capital (Currency in million, as of most recent reporting date)	BGN 139 million
9	Nominal amount of instrument	BGN 1
9a	Issue price	100%
9b	Redemption price	100%
10	Accounting classification	Shareholders' equity
11	Original date of issuance	28-09-2001
12	Perpetual or dated	Perpetual
13	Original maturity date	N/A
14	Issuer call subject to prior supervisory approval	Yes
15	Optional call date, contingent call dates and redemption amount	N/A
16	Subsequent call dates, if applicable	N/A
<b>Coupons/dividends</b>		
17	Fixed or floating dividend/coupon	Floating
18	Coupon rate and any related index	N/A
19	Existence of a dividend stopper	No
20a	Fully discretionary, partially discretionary or mandatory (in terms of timing)	Fully discretionary
20b	Fully discretionary, partially discretionary or mandatory (in terms of amount)	Fully discretionary
21	Existence of step up or other incentive to redeem	N/A
22	Noncumulative or cumulative	N/A
23	Convertible or non-convertible	N/A
24	If convertible, conversion trigger(s)	N/A
25	If convertible, fully or partially	N/A
26	If convertible, conversion rate	N/A
27	If convertible, mandatory or optional conversion	N/A
28	If convertible, specify instrument type convertible into	N/A
29	If convertible, specify issuer of instrument it converts into	N/A
30	Write-down features	N/A
31	If write-down, write-down trigger(s)	N/A
32	If write-down, full or partial	N/A
33	If write-down, permanent or temporary	N/A
34	If temporary write-down, description of write-up mechanism	N/A
35	Position in subordination hierarchy in liquidation (specify instrument type immediately senior to instrument)	N/A
36	Non-compliant transitioned features	No
37	If yes, specify non-compliant features	N/A

Disclosure of nature and amounts of specific items in own funds is presented below in accordance with the requirements of Regulation 575/2013:

**Table 4: Transitional Own Funds Disclosure template**  
BGN thousand

	Position	(A) AMOUNT AT 31.12.2014	(B) REGULATION (EU) NO 575/2013 ARTICLE REFERENCE	(C) AMOUNTS SUBJECT TO PRE- REGULATION (EU) NO 575/2013 TREATMENT OR PRESCRIBED RESIDUAL AMOUNT OF REGULATION (EU) NO 575/2013
1	Capital instruments and the related share premium accounts	139,130	26 (1), 27, 28, 29, EBA list 26 (3)	N/A
	of which: Instrument type 1	139,130	EBA list 26 (3)	N/A
	of which: Instrument type 2	-	EBA list 26 (3)	N/A
	of which: Instrument type 3	-	EBA list 26 (3)	N/A
2	Retained earnings		26 (1) (c)	N/A
3	Accumulated other comprehensive income (and other reserves, to include unrealised gains and losses under the applicable accounting standards)	10,416	26 (1)	N/A
3a	Funds for general banking risk	-	26 (1) (f)	N/A
4	Amount of qualifying items referred to in Article 484 (3) and the related share premium accounts subject to phase out from CET1	-	486 (2)	N/A
	Public sector capital injections grandfathered until 1 January 2018	-	483 (2)	N/A
5	Minority Interests (amount allowed in consolidated CET1)	-	84, 479, 480	N/A
5a	Independently reviewed interim profits net of any foreseeable charge or dividend	-	26 (2)	N/A
<b>6</b>	<b>Common Equity Tier 1 (CET1) capital before regulatory adjustments</b>	<b>149,546</b>		
<b>Common Equity Tier 1 (CET1) capital: regulatory adjustments</b>				
7	Additional value adjustments (negative amount)	-	34, 105	N/A
8	Intangible assets (net of related tax liability) (negative amount)	-3,569	36 (1) (b), 37, 472 (4)	N/A
9	Empty Set in the EU	-		
10	Deferred tax assets that rely on future profitability excluding those arising from temporary differences (net of related tax liability where the conditions in Article 38 (3) are met) (negative amount)	-	36 (1) (c), 38, 472 (5)	N/A
11	Fair value reserves related to gains or losses on cash flow hedges	-	33 (a)	N/A
12	Negative amounts resulting from the calculation of expected loss amounts	-	36 (1) (d), 40, 159, 472 (6)	N/A
13	Any increase in equity that results from securitised assets (negative amount)	-	32 (1)	N/A
14	Gains or losses on liabilities valued at fair value resulting from changes in own credit standing	-	33 (b)	N/A
15	Defined-benefit pension fund assets (negative amount)	-	36 (1) (e), 41, 472 (7)	N/A
16	Direct and indirect holdings by an institution of own CET1 instruments (negative amount)	-	36 (1) (f), 42, 472 (8)	N/A
17	Holdings of the CET1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	36 (1) (g), 44, 472 (9)	N/A
18	Direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions) (negative amount)	-	36 (1) (h), 43, 45, 46, 49 (2) (3), 79, 472 (10)	N/A
19	Direct, indirect and synthetic holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	36 (1) (i), 43, 45, 47, 48 (1) (b), 49 (1) to (3), 79, 470, 472 (11)	N/A
20	Empty Set in the EU	-		
20a	Exposure amount of the following items which qualify for a RW of 1250%, where the institution opts for the deduction alternative	-	36 (1) (k)	N/A
20b	of which: qualifying holdings outside the financial sector (negative amount)	-	36 (1) (k) (i), 89 to 91	N/A
20c	of which: securitisation positions (negative amount)	-	36 (1) (k) (ii), 243 (1) (b), 244 (1) (b) 258	N/A
20d	of which: free deliveries (negative amount)	-	36 (1) (k) (iii), 379 (3)	N/A
21	Deferred tax assets arising from temporary differences (amount above 10% threshold, net of related tax liability where the conditions in 38 (3) are	-	36 (1) (c), 38, 48 (1) (a), 470,	N/A

	met) (negative amount)		472 (5)	
22	Amount exceeding the 15% threshold (negative amount)	-	48 (1)	N/A
23	of which: direct and indirect holdings by the institution of the CET1 instruments of financial sector entities where the institution has a significant investment in those entities	-	36 (1) (i), 48 (1) (b), 470, 472 (11)	N/A
24	Empty Set in the EU	-		N/A
25	of which: deferred tax assets arising from temporary differences	-	36 (1) (c), 38, 48 (1) (a), 470, 472 (5)	N/A
25a	Losses for the current financial year (negative amount)	-	36 (1) (a), 472 (3)	N/A
25b	Foreseeable tax charges relating to CET1 items (negative amount)	-	36 (1) (1)	N/A
26	Regulatory adjustments applied to Common Equity Tier 1 in respect of amounts subject to pre-CRR treatment	-419		N/A
26a	Regulatory adjustments relating to unrealised gains and losses pursuant to Articles 467 and 468	-		N/A
	Of which:.... filter for unrealised loss 1	-	467	N/A
	Of which: ... filter for unrealised loss 2	-	467	N/A
	Of which: ... filter for unrealised gain 1	-	468	N/A
	Of which: ... filter for unrealised gain 2	-	468	N/A
266	Amount to be deducted from or added to Common Equity Tier 1 capital with regard to additional filters and deductions required pre CRR	-419	481	N/A
	Of which: ...	-	481	N/A
27	Qualifying AT1 deductions that exceed the AT1 capital of the institution (negative amount)	-	36 (1) (j)	N/A
28	<b>Total regulatory adjustments to Common equity Tier 1 (CET1)</b>	<b>-3,988</b>		<b>N/A</b>
29	<b>Common Equity Tier 1 (CET1) capital</b>	<b>145,558</b>		<b>N/A</b>
<b>Additional Tier 1 (AT1) capital: instruments</b>				
30	Capital instruments and the related share premium accounts	51, 52	51-52	N/A
31	of which: classified as equity under applicable accounting standards			N/A
32	of which: classified as liabilities under applicable accounting standards			N/A
33	Amount of qualifying items referred to in Article 484 (4) and the related share premium accounts subject to phase out from AT1	486 (3)	486(3)	N/A
	Public sector capital injections grandfathered until 1 January 2018	483 (3)	483 (3)	N/A
34	Qualifying Tier 1 capital included in consolidated AT1 capital (including minority interests not included in row 5) issued by subsidiaries and held by third parties	85, 86, 480	85, 86 and 480	N/A
35	of which: instruments issued by subsidiaries subject to phase out	486 (3)	486 (3)	N/A
36	Additional Tier 1 (AT1) capital before regulatory adjustments	-		N/A
<b>Additional Tier 1 (AT1) capital: regulatory adjustments</b>				
37	Direct and indirect holdings by an institution of own AT1 Instruments (negative amount)	-	52 (1) (b), 56 (a), 57, 475 (2)	N/A
38	Holdings of the AT1 instruments of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	56 (b), 58, 475 (3)	N/A
39	Direct and indirect holdings of the AT1 instruments of financial sector entities where the institution does not have a significant investment in those entities (amount above the 10% threshold and net of eligible short positions) (negative amount)	-	56 (c), 59, 60, 79, 475 (4)	N/A
40	Direct and indirect holdings by the institution of the AT1 instruments of financial sector entities where the institution has a significant investment in those entities (amount above the 10% threshold net of eligible short positions) (negative amount)	-	56 (d), 59, 79, 475 (4)	N/A
41	Regulatory adjustments applied to additional tier 1 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts.)	-		
41a	Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	-	472, 472(3)(a), 472 (4), 472 (6), 472 (8) (a), 472 (9), 472 (10) (a), 472 (11) (a)	N/A
41b	Residual amounts deducted from Additional Tier 1 capital with regard to deduction from Tier 2 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	-	477, 477 (3), 477 (4) (a)	N/A
	Of which items to be detailed line by line, e.g. Reciprocal cross holdings in Tier 2 instruments, direct holdings of non-significant investments in the capital of other financial sector entities, etc.	-		N/A
41c	Amount to be deducted from or added to Additional Tier 1 capital with regard to additional filters and deductions required pre- CRR	-	467,468, 481	N/A
	Of which: ... possible filter for unrealised losses	-	467	N/A

	Of which: ... possible filter for unrealised gains	-	468	N/A
	Of which: ...	-	481	N/A
42	Qualifying T2 deductions that exceed the T2 capital of the institution (negative amount)	-	56(e)	N/A
43	Total regulatory adjustments to Additional Tier 1 (AT1) capital	-		N/A
44	Additional Tier 1 (AT1) capital	-		N/A
45	Tier 1 capital (T1 = CET1 + AT1)	145,558		N/A
<b>Tier 2 (T2) capital: instruments and provisions</b>				
46	Capital instruments and the related share premium accounts	-	62, 63	N/A
47	Amount of qualifying items referred to in Article 484 (5) and the related share premium accounts subject to phase out from T2	1,277	486 (4)	N/A
	Public sector capital injections grandfathered until 1 January 2018	-	483 (4)	
48	Qualifying own funds instruments included in consolidated T2 capital (including minority interests and AT1 instruments not included in rows 5 or 34) issued by subsidiaries and held by third parties	-	87, 88, 480	
49	of which: instruments issued by subsidiaries subject to phase out	-	486 (4)	
50	Credit risk adjustments	-	62 (c) & (d)	
51	<b>Tier 2 (T2) capital: regulatory adjustments</b>	1,277		N/A
52	Direct and indirect holdings by an institution of own T2 instruments and subordinated loans (negative amount)	-	63 (b) (i), 66 (a), 67, 477 (2)	
53	Holdings of the T2 instruments and subordinated loans of financial sector entities where those entities have reciprocal cross holdings with the institution designed to inflate artificially the own funds of the institution (negative amount)	-	66 (b), 68, 477 (3)	
54	Direct and indirect holdings of the T2 instruments and subordinated loans of financial sector entities where the institution does not have a significant investment in those entities (amount above 10% threshold and net of eligible short positions) (negative amount)	-	66 (c), 69, 70, 79, 477 (4)	
54a	Of which new holdings not subject to transitional arrangements	-		
54b	Of which holdings existing before 1 January 2013 and subject to transitional arrangements	-		
55	Direct and indirect holdings by the institution of the T2 instruments and subordinated loans of financial sector entities where the institution has a significant investment in those entities (net of eligible short positions) (negative amount)	-	66 (d), 69, 79, 477 (4)	
56	Regulatory adjustments applied to tier 2 in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	-		
56a	Residual amounts deducted from Tier 2 capital with regard to deduction from Common Equity Tier 1 capital during the transitional period pursuant to article 472 of Regulation (EU) No 575/2013	-	472, 472(3)(a), 472 (4), 472 (6), 472 (8) (a), 472 (9), 472 (10) (a), 472 (11) (a)	
	Of which items to be detailed line by line, e.g. Material net interim losses, intangibles, shortfall of provisions to expected losses etc.	-		
56b	Residual amounts deducted from Tier 2 capital with regard to deduction from Additional Tier 1 capital during the transitional period pursuant to article 475 of Regulation (EU) No 575/2013	-	475, 475 (2) (a), 475 (3), 475 (4) (a)	
	Of which items to be detailed line by line, e.g. reciprocal cross holdings in at1 instruments, direct holdings of non-significant investments in the capital of other financial sector entities, etc.	-		
56c	Amount to be deducted from or added to Tier 2 capital with regard to additional filters and deductions required pre CRR	-	467, 468, 481	
	Of which: ... possible filter for unrealised losses	-	467	
	Of which: ... possible filter for unrealised gains	-	468	
	Of which: ...	-	481	
57	Total regulatory adjustments to Tier 2 (T2) capital	0		
58	Tier 2 (T2) capital	1,277		N/A
59	Total capital (TC = T1 + T2)	146,835		N/A
59a	Risk weighted assets in respect of amounts subject to pre-CRR treatment and transitional treatments subject to phase out as prescribed in Regulation (EU) No 575/2013 (i.e. CRR residual amounts)	-		N/A
	"Of which: ... items not deducted from CET1 (Regulation (EU) No 575/2013 residual amounts)	-	472, 472 (5), 472 (8) (b), 472 (10) (b), 472(11)(b)	N/A
	(items to be detailed line by line, e.g. Deferred tax assets that rely on future profitability net of related tax liability, indirect holdings of own CET1, etc.)"	-	475, 475 (2) (b), 475 (2) (c), 475 (4) (b)	N/A
	"Of which: ... items not deducted from AT1 items (Regulation (EU) No 575/2013 residual amounts)	-	477, 477 (2) (b), 477 (2) (c), 477 (4) (b)	N/A

<b>60</b>	<b>Total risk weighted assets</b>		<b>797,683</b>		<b>N/A</b>
<b>Capital ratios and buffers</b>					
61	Common Equity Tier 1 (as a percentage of risk exposure amount)		18.25%	92 (2) (a), 465	N/A
62	Tier 1 (as a percentage of risk exposure amount)		18.25%	92 (2) (b), 465	N/A
63	Total capital (as a percentage of risk exposure amount)		18.41%	92 (2) (c)	N/A
64	Institution specific buffer requirement (CET1 requirement in accordance with article 92 (1) (a) plus capital conservation and countercyclical buffer requirements, plus systemic risk buffer, plus the systemically important institution buffer (G-SII or O-SII buffer), expressed as a percentage of risk exposure amount)		5.50%	CRD 128, 129, 130	N/A
65	of which: capital conservation buffer requirement		2.50%		N/A
66	of which: countercyclical buffer requirement		-		
67	of which: systemic risk buffer requirement		3.00%		N/A
67a	of which: Global Systemically Important Institution (G-SII) or Other Systemically Important Institution (O-SII) buffer		-	CRD 131	N/A
68	Common Equity Tier 1 available to meet buffers (as a percentage of risk exposure amount)		13.75%	CRD 128	N/A
69	[non relevant in EU regulation]		-		
70	[non relevant in EU regulation]		-		
71	[non relevant in EU regulation]		-		
<b>Amounts below the thresholds for deduction (before risk weighting)</b>					
72	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		-	36 (1) (h), 45, 46, 472 (10), 56 (c), 59, 60, 475 (4), 66 (c), 69, 70, 477 (4)	N/A
73	Direct and indirect holdings by the institution of the CET 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		-	36 (1) (i), 45, 48, 470, 472 (11)	N/A
74	Empty Set in the EU		-		
75	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)		-	36 (1) (c), 38, 48, 470, 472 (5)	N/A
<b>Applicable caps on the inclusion of provisions in Tier 2</b>					
76	Direct and indirect holdings of the capital of financial sector entities where the institution does not have a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		-	62	N/A
77	Direct and indirect holdings by the institution of the CET 1 instruments of financial sector entities where the institution has a significant investment in those entities (amount below 10% threshold and net of eligible short positions)		-	62	N/A
78	Empty Set in the EU		-	62	N/A
79	Deferred tax assets arising from temporary differences (amount below 10% threshold, net of related tax liability where the conditions in Article 38 (3) are met)		-	62	N/A
<b>Capital instruments subject to phase-out arrangements (only applicable between 1 Jan 2013 and 1 Jan 2022)</b>					
80	Current cap on CET1 instruments subject to phase out arrangements		-	484 (3), 486 (2) & (5)	N/A
81	Amount excluded from CET1 due to cap (excess over cap after redemptions and maturities)		-	484 (3), 486 (2) & (5)	N/A
82	Current cap on AT1 instruments subject to phase out arrangements		-	484 (4), 486 (3) & (5)	N/A
83	Amount excluded from AT1 due to cap (excess over cap after redemptions and maturities)		-	484 (4), 486 (3) & (5)	N/A
84	Current cap on T2 instruments subject to phase out arrangements		-	484 (5), 486 (4) & (5)	N/A
85	Amount excluded from T2 due to cap (excess over cap after redemptions and maturities)		-	484 (5), 486 (4) & (5)	N/A

### 3.3. Capital requirements and adequacy of equity

When defining the capital requirements for the purposes of calculation of capital adequacy as per Regulation 575/2013, the Bank adheres to the following:

1. Capital requirements for credit risk and counterparty risk – Standardised approach as per Part Three, Section II, Chapter 2 of Regulation 575/2013.
2. Capital requirements for operational risk – Standardized approach as per part Three, Section III, Chapter 3 of Regulation 575/2013.

As per 31.12.2014 there is no capital requirement for market risk, as the Bank has no trading portfolio under Regulation 575/2013 on the capital adequacy of credit institutions. The Bank does not have positions for trading, which are positions in financial instruments and commodities held for short-term resale or profit from the difference between sale and purchase prices arising from actual or expected short-term price differences on the market.

ProCredit Bank does not calculate a capital requirement for currency risk, as the overall net foreign currency position (excluding EUR) as of 31.12.2014 is (-0.32%) of the capital, which is less than minimum threshold of 2% according to Regulation 575/2013.

As per Art. 92 of Regulation 575/2013, the minimum capital requirement for the overall capital adequacy ratio is 8% of the total risk exposure. Added to this requirement are the capital buffers, which the Bulgarian National Bank demands that the banks maintain as per Regulation No. 8 on the capital buffers of banks. They are:

- capital conservation buffer in the form of Common Equity Tier 1 equal to 2.5% of total risk exposure;
- systemic risk buffer in the form of Common Equity Tier 1 capital equal to 3.0% of the total risk exposure.

After adding the capital buffers to the capital requirements, the minimum requirement amounts to 13.5%.

The table below shows the risk-weighted assets and capital requirements by types of risk and exposure class, needed for the minimum common base of capital adequacy with and without the capital buffers as set by the Bulgarian National Bank. Classes to which the Bank is not exposed are not shown. The calculations are made as per Regulation 575/2013:

**Table 5: Risk-weighted exposure**

<i>BGN thousands</i>	31-12-2014		
Exposure class/risk	Risk-weighted assets	Capital requirements without capital buffers	Capital requirements with capital buffers included
<b>Credit risk – standardised approach</b>	<b>652,852</b>	<b>52,228</b>	<b>88,135</b>
Central governments or central banks	4,180	334	564
Multilateral Development Banks	-	-	-
Institutions	29,205	2,336	3,943
Corporates	54,477	4,358	7,354
Retail exposures	301,251	24,100	40,669
Exposures secured by mortgages on immovable property	181,140	14,491	24,454
Exposures in default	24,888	1,991	3,360
Equity exposures	947	76	128
Other items*	56,764	4,541	7,663
<b>Operational risk – standardised approach</b>	<b>144,831</b>	<b>11,586</b>	<b>19,552</b>
<b>Overall risk exposure</b>	<b>797,683</b>	<b>63,815</b>	<b>107,687</b>

\* Other items include: cash, fixed assets; seized assets; other assets in the balance

The regulatory capital ratios are calculated by dividing the capital by the amount of the risk-weighted assets; when calculating each ratio, only the respective capital components are considered (of the Common Equity Tier 1 capital and of the overall capital adequacy). The table below shows information about the regulatory capital ratios:

**Table 6: Capital ratios**

<i>BGN thousands</i>	31-12-2014	
Capital	Value	
Common Equity Tier 1	145,558	
Tier 1 capital	145,558	
Total capital	146,835	
<b>Overall risk exposure</b>	<b>797,683</b>	
Capital ratios	Value	Minimum legal requirement
Common Equity Tier 1 capital	18.2%	10.0%
Tier 1 capital	18.2%	11.5%
Total capital	18.4%	13.5%

### 3.4. Adequacy of internal capital (risk-bearing capacity)

The risk-bearing capacity concept is a key element of risk management and of the Internal Capital Adequacy Assessment Process (ICAAP), on both ProCredit group and Bank levels. The adequacy of internal capital assessment entails defining the risk-bearing capacity of the Bank. The current capital resources are compared to the capital needs, which are derived from the risk profile and risk exposure, in order to guarantee the sufficiency of the capital resources at any moment. This is a continuous process which provides clarity on capital requirements and exposure to material risks.

The methodology used for calculating the economic capital required to cover all risks is based on applicable and available statistical models. The methodology was developed by ProCredit Holding and is implemented in all institutions of the ProCredit group. Extreme scenarios are applied, some of which have been historically observed in certain countries in which the ProCredit group operates and the shock-bearing capacity is tested. The leading principle when calculating the risk-bearing capacity is that the Bank is capable of bearing extreme shock scenarios without jeopardizing the interests of the depositors and other creditors. The years 2009 and 2010, as part of economic crisis period, have shown that, on the one hand, a conservative approach to capital management is needed, and on the other, that the ProCredit group and the Bank have the capacity to deal with difficult economic environments.

The approach adopted for management and monitoring of the risk-bearing capacity is the “gone concern” approach. Assessment is made of the outcomes from the occurrence of an extreme operational environment, including situations which have not occurred as historical data and outcomes of various stress scenarios. Under the “gone concern” approach, a sufficient buffer is included to cover risk positions which are either not considered essential, or cannot be measured and have the potential for loss.

The material risks, as well as the applicable limits for each risk, for which the required capital is calculated, reflect the risk profile of ProCredit Bank, and are subject to annual revisions. These risks are: credit risk, counterparty risk (including issuer risk), interest rate risk, FX risk and operational risk.

Within ICAAP ProCredit Bank compares the calculated economic capital needed for the various risks to the available capital. For the purposes of ICAAP, the available capital is considered as risk-taking potential (RTP) and comprises the equity as per the financial statements, minus the intangible assets and the deferred tax assets plus Tier 2 capital. The resources available to cover risks (RA<sub>t</sub>CR) are calculated as 60% of the RTP. Only RA<sub>t</sub>CR are considered when setting the limits for each risk category. Thus a buffer of 40% of the RTP is available to cover possible shortcomings of the applied models and unfavourable effects, which can be associated with risks which have not been explicitly included in the risk-bearing capacity calculation. The table below gives more details on the calculated internal capital within the ICAAP as well as on the risk taking potential:

**Table 7: Internal capital adequacy assessment**

<i>BGN thousands</i>	31-12-2014			
<b>Material risks</b>	<b>Reporting trigger (% of the RTP)</b>	<b>Reporting trigger (amount)</b>	<b>Economic capital requirements</b>	<b>Economic capital as % of the reporting trigger amount</b>
Credit risk	33%	59,460	22,504	38%
Counterparty risk – banks	1%	1,802	8	0%
Counterparty risk – sovereigns	4%	7,207	759	11%
FX risk	2%	3,604	177	5%
Interest rate risk	10%	18,018	32	0%
Operational risk	10%	18,018	12,663	70%
<b>Resources available to cover risks (RAtCR) (limited at 60% of RTP)</b>		<b>108,110</b>	<b>36,143</b>	<b>33%</b>
<b>Risk-taking potential (RTP)</b>		<b>180,183</b>		

As shown in the table, ProCredit Bank only needs 33% of the resources available to cover risks to secure capital adequacy, which is adequate to the risk profile of the institution.

#### **IV. Credit risk**

Credit risk is the risk that the counterparty in a credit agreement will not be able to fulfil the duties under the agreement or that it can only fulfil them partly. The main credit risk generating activity is providing loans to clients of the Bank. The credit risk bearing assets are the credit exposures thus formed (incl. contingent liabilities undertaken in the form of bank guarantee and letters of credit). Activities related to the storage of liquid assets (receivables from banks, security investments) also generate credit risk which is defined as counterparty risk (including issuer risk).

##### **4.1. Credit risk related to the clients of the Bank**

###### **4.1.1. Strategy and principles**

The key aims of the credit risk management strategy are achieving and maintaining the high quality of the credit portfolio, low level concentrations, sufficient coverage of the credit risk with provisions for impairment losses and an adequate return on the risk taken in lending.

The Bank has implemented a comprehensive system for the assessment and management of credit risk. Credit risk management begins with the process of client acquisition and continues during financial analysis and risk assessment. The formation of an exposure is followed by mandatory ongoing monitoring as well as corrective activities when needed.

ProCredit Bank has clear criteria for the clients, with whom it enters into business relationships, i.e.:

- sustainable business model;
- good capitalization and financial stability;
- clear ownership and managerial expertise;
- availability of development plans;
- very good financial history.

In its credit relationships with clients, ProCredit Bank adopts to the following principles:

- intensive analysis of the plausibility for liabilities on behalf of the clients;
- comprehensive documentation of the credit analysis and the activities related to the lending operations;
- strict avoidance of creating over-indebtedness for clients;
- development of long-term relationships with the clients and maintaining regular contact;
- direct client-oriented approach for intensive management of the exposure in case of default;
- seizure of collateral in case of insolvency.

The credit risk management principles are approved by the Management Board and are included in the respective policies and standards. The policies define the credit risk

management responsibilities, the lending process structure and the collateral assessment standards for the credit exposures, as well as the rules for provisioning for impairment and write-off. The credit operations with business clients and private clients are set forth in detail, along with the services available.

Depending on the client category (very small, small or medium business clients, and private clients) different approaches are adopted for the credit risk assessment. The difference lies in the distribution of responsibilities, the information on which the credit analysis is based, the decision making criteria for loan approval and the collateral requirements.

In accordance with the credit risk management policy, all lending decisions are made by a credit committee. The committee members are authorised to approve credit exposures up to amounts commensurate with their level of competence. Decisions which involve significant credit risk exposures (over EUR 50,000) are made by a credit committee with a representative/representatives from the Head Office. Significant components of the decision making process are the definition of precise credit limits and the selection of suitable credit products which correspond to the financial needs of the client. Increasing individual credit exposures is only allowed within the approved limits, which are subject to strict monitoring. In case of deterioration of a client's credit portfolio, the Bank has a fast procedure to limit the increase of the credit exposure.

The credit risk management policy includes rules for adequate collateral, which limit the possibility to conclude non-collateralized loan agreements. Depending on the level of the assessed risk and the term of the exposure, certain loans can be approved without overall collateral coverage. As a general rule, the exposures of clients of higher risk profile are collateralized, usually by real estate mortgage.

The quality of the credit operations is subject to monitoring by a specialized control unit, which assesses the quality of the credit analysis, approves the compliance with the internal policies and identifies fraud. The unit is staffed with employees experienced in lending, who visit the clients on site to check the credit process and who review the loan portfolios for flaws.

The loan portfolio of the Bank comprises exposures which are repaid in monthly instalments. Thus, the occurrence of default in payment is a reliable indicator for increased credit risk. Daily reports on defaulted exposures are submitted to the branch managers, the Head Office and ProCredit Holding and activities are initiated in accordance with the relevant rules. The early risk triggers and the regular monitoring of the clients ensure reliable identification of increased credit risk on an individual level.

In cases when there is increased risk of default for a credit exposure, the latter is placed under special management. Its key features are direct communication with the client, identification of the source for increased risk and comprehensive monitoring of the business activity of the client. As a result of such analysis, the repayment plan of the exposure could be revised so that it is appropriate to the client's current and future payment capacity. During the special management process of an exposure the Business Client Adviser can be supported by an expert, who is qualified in working with increased risk exposures (Expert Loan Portfolio Management).

When a credit exposure status is qualified as problematic, an Expert Loan Portfolio Management takes on the responsibility for further activities. When necessary, the latter is supported by a Legal Advisor – Court Receivables or an Expert Assets and Collateral Sales.

The most important indicators when reviewing the credit portfolio quality are the indicators for the share of loans in arrears over 30 and over 90 days relative to the total loan portfolio (indicators of portfolio at risk). Also monitored is the level at which exposures in arrears over 30 and over 90 days are covered by provisions for impairment losses as an indicator of the adequacy of the provisioning of the loan portfolio.

#### 4.1.2. Structure and concentration risk of the credit portfolio

The Bank maintains a highly diversified portfolio. This arises from the business model, which involves the formation of exposures to clients that vary in terms of sector, geographical location, size and complexity of the business. The loan portfolio is characterized by its large number of exposures not concentrated in a limited field of borrowers. The tables below contain information about the portfolio structure and illustrate the limited concentration risk.

**Table 8: Distribution of the loan portfolio by client category**

BGN thousands	31-12-2014	
	Gross amount before impairment	Share
Business clients	990,490	96.1%
Private clients	39,949	3.9%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

The business clients loan portfolio includes exposures to both self-employed persons and business owners.

**Table 9: Distribution of the loan portfolio according to residual amount of exposure**

BGN thousands	31-12-2014	
	Gross amount before impairment	Share
<=10,000	44,066	4.3%
>10,000<=30,000	105,133	10.2%
>30,000<=50,000	97,226	9.4%
>50,000<=250,000	261,225	25.4%
>50,000<=250,000	131,620	12.8%
>250,000<=500,000	155,093	15.1%
>500,000<=1,000,000	125,318	12.2%
>1,000,000	110,758	10.7%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

**Table 10: Distribution of the loan portfolio by sectors**

<i>BGN thousands</i>	31-12-2014	
<b>Sector</b>	<b>Gross amount before impairment</b>	<b>Share</b>
Trade; repair of motor vehicles and motorcycles	284,385	27.6%
Agriculture, forestry and fishing	256,165	24.9%
Production	170,212	16.5%
Construction	60,215	5.8%
Hotels and restaurants	55,202	5.4%
Transportation, storage and postal services	54,738	5.3%
Activities of households	49,625	4.8%
Professional activities and scientific research	25,000	2.4%
Real estate operations	16,502	1.6%
Creating and distribution of information and creative products; telecommunications	16,013	1.6%
Other activities	42,382	4.1%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

In the loan portfolio of 2014 there has been an increase in the portion of loans to businesses dealing in agriculture and production (2014: 41.4%; 2013: 37.6%) and a decrease of trading activities (2014: 27.6%; 2013: 29.7%).

**Table 11: Distribution of the loan portfolio by geographical regions**

<i>BGN thousands</i>	31-12-2014	
<b>Geographical region</b>	<b>Gross amount before impairment</b>	<b>Share</b>
Centre-South (Plovdiv)	215,896	21.0%
Northeast (Varna)	189,926	18.4%
Sofia	189,241	18.4%
Southeast (Burgas)	144,703	14.0%
Northwest (Pleven)	125,155	12.1%
South (Stara Zagora)	110,720	10.7%
Southwest (Blagoevgrad)	52,145	5.1%
Outside Bulgaria	2,653	0.3%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

**Table 12: Distribution of the loan portfolio by type of loan**

<i>BGN thousands</i>	<i>31-12-2014</i>	
Type of loan	Gross amount before impairment	Share
Business instalment loan	648,349	62.9%
Revolving business loan	192,048	18.6%
Housing loan	89,038	8.6%
Business overdraft	88,197	8.6%
Consumer instalment loan	9,748	0.9%
Consumer overdraft	3,059	0.3%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

**Table 13: Distribution of the loan portfolio by number of days in arrears**

<i>BGN thousands</i>	<i>31-12-2014</i>	
Number of days in arrears	Gross amount before impairment	Share
no arrears	958,679	93.0%
from 1 to 30 days	30,084	2.9%
from 31 to 90 days	5,794	0.6%
from 91 to 180 days	6,011	0.6%
over 180 days	29,871	2.9%
<b>Total</b>	<b>1,030,439</b>	<b>100.0%</b>

The table above shows that the Bank's efforts to maintain a loan portfolio of high quality have been successful. The indicator for the net exposures in arrears for more than 90 days (after deduction of the impairment provisions) amounts to 2.1% of the total loan portfolio as of 31.12.2014.

#### 4.1.3. Exposures in arrears and impaired loans

The methodology for calculation of provisions for impairment losses is based on the Group Standards for Provisions and Write-Offs issued by ProCredit Holding, on the requirements of the laws on banking and on the applicable accounting standards. When defining the impairment losses, the Bank separates the credit exposures into individually significant, if the residual amount higher than EUR 30,000, and individually insignificant if the residual amount is up to EUR 30,000. The definitions for impairment and arrears are the following:

**Impairment** - impairment of a disbursed loan or a receivable is when there is objective proof of deterioration of the quality of the asset (in this case, the credit exposure to the client). The basic indicators for impairment of a credit exposure are:

- Payments more than 30 days overdue;
- The exposure has been accelerated;

- The exposure is subject to court proceedings or the court has ruled in favour of the Bank;
- The debtor is declared insolvent or is in liquidation proceedings;
- Availability of information about the client's business or about changes in the market environment, which have a negative effect on the client's capacity to fulfil the agreement obligations for payments to the Bank.

Also, in cases of specific individually significant exposures, an individual impairment assessment is made. In such cases, only if the assessment affirms that the exposure is impaired is the exposure classified as such.

**Default** – default is when the borrower has failed to fulfil entirely or partly an obligation for payment of outstanding principal, interest or fees within the agreed terms.

As of every reporting date, the Bank decides whether there is objective evidence of impairment of a financial asset or a group of financial assets and if such are found, then the total amount of the respective losses is immediately recognized in the profit and loss statement. Depending on the size of the loans, these losses are calculated either on an individual or on a portfolio basis in relation to portfolio exposures. The balance of the exposure is deducted by applying an impairment account and the amount of the loss is recognized in the profit and loss statement. Losses related to expected future events are not recognized.

When defining the impairment provisions the portfolio of the Bank is divided into two basic exposure groups:

**a) Individually significant exposures, which are assessed individually**

Such exposures are subject to assessment for availability of objective evidence of impairment, which includes any factor that can possibly have an effect on the client's capacity to fulfil the agreed obligations to the Bank, i.e.:

- Arrears or default in payment of outstanding debts;
- Breach of terms or requirements under the loan agreement;
- Initiation of court action or bankruptcy proceedings;
- Specific information on the client's activity;
- Change in the client's market;
- The general economic environment.

Provided there is objective evidence of impairment, the amount of loss is calculated as the difference between the balance amount of the exposure and the present value of the expected future cash flows, which are discounted by the effective interest rate on the exposure. The calculation of the present value of the expected future payments under collateralized financial assets reflects the cash flows from the realization of the collateral, less the expenses for seizure and sale.

**b) Exposures which are assessed on a portfolio basis**

There are two cases in which exposures are assessed on a portfolio basis:

- Individually insignificant exposures for which there is objective evidence of impairment;
- The outstanding portfolio of individually significant and individually insignificant exposures, for which there is no evidence of impairment.

For the purposes of defining the impairment of individually insignificant exposures, the latter are grouped according to the number of days in arrears. Arrears over 30 days are accepted as proof of impairment. The number of days in arrears has a practical significance when defining the percentage of loss from impairment, which is considered when calculating the provisions for impaired individually insignificant exposures. Impaired loans grouped by number of days in arrears are as follows:

1. over 30 and up to 90 days in arrears;
2. over 90 and up to 180 days in arrears;
3. over 180 days in arrears.

The definition of portfolio-based impairment for individually insignificant impaired exposures (specific provisions for general impairment) and of unimpaired exposures (provisions for portfolio impairment) is based on a qualitative analysis of historical levels of default for portfolios with similar characteristics. The historical data for defaults are analysed annually. The analysis results are used to define the applicable percentages for provisioning and to check the viability of the percentages for the previous year.

The sufficiency of the provisions is controlled by the Management Board, the Credit Committee on Restructuring and the General Risk Assessment Committee at their regular meetings.

When there is a reduction in the provisions for impairment loss, it is recognized as revenue for the relevant period.

When an exposure is specified as uncollectible, it is written off at the expense of the calculated provisions for impairment loss. Such exposures are written off from the balance of the Bank after completing all necessary procedures and after calculating the amount of the loss. Recovered amounts on written-off exposures are recognized as revenue through decreasing the accrued provisions for impairment loss for the year.

The change in the provisions for impairment loss during the reporting period was as follows:

**Table 14: Adjustment of the changes in the credit risk adjustments**

BGN thousands	Specific provisions for individually assessed exposures	Specific provisions for collectively assessed exposures	General provisions for incurred but not reported losses	Total provisions for impairment loss
Balance as per 01.01.2014	17,612	4,047	13,376	35,035
Increases	10,151	5,084	8,135	23,370
Deductions	(4,581)	(1,608)	(7,851)	(14,040)
Amounts applied for write-offs	(4,351)	(4,578)	-	(8,929)
Transfers	(445)	144	301	-
Other adjustments	113	513	277	903
<b>Balance as per 31.12.2014</b>	<b>18,499</b>	<b>3,602</b>	<b>14,238</b>	<b>36,339</b>

#### 4.2. Exposure to counterparty risk (including issuer risk)

ProCredit Bank defines counterparty risk as the risk that a certain counterparty cannot fulfil their obligations to the Bank within the agreed period of time or in the full amount of the exposure. For the purposes of the disclosure on this item, we have assumed that counterparties are banks or governments. The following risks are included: for the current exposure, replacement of a current agreement; settlement risk. The risk of the counterparty is limited, being related to the support of highly liquid assets for the purposes of liquidity risk management. There is also a structural exposure to the central bank in the form of minimum mandatory reserves.

The highly liquid assets are invested prudently and with a high level of diversification, only cooperating with banks which have been pre-approved and possess a high credit rating. The exposures are of short maturity (up to 3 months) and only simple financial instruments are used. With regard to investments in securities it is not allowed to participate in speculative trading transactions in order to obtain short-term profits. The Bank principally invests in highly liquid securities which have a fixed interest rate and a maturity of up to 2 years. Investments are only made in financial instruments which are issued by Bulgaria or other countries or supranational institutions with a long-term credit rating of at least AA- (according to the scale applied by Fitch Ratings for external credit assessments).

The Bank aims at reducing the counterparty risk exposure by:

- Completing a comprehensive assessment of each new counterparty before closing an agreement (including an assessment of the anti-money laundering measures as per the Bank's anti-money laundering policy, and an analysis of the financial stability);
- Limiting the exposure of the Bank to the various counterparties;
- Maintaining the numbers of counterparties within a manageable size and of correspondent banks at a minimum level, in accordance with business needs;
- Regularly reviewing the approved counterparties and the accepted limits.

The overall exposure to a counterparty is defined as the sum of all current agreements with the counterparty, either by market or nominal value, depending on the type of operation. When defining the limit, every transaction has the same weight. Thus, the overall limit can be

freely distributed among the various agreements which have been approved for closing with a certain counterparty. In spite of this, whenever there are doubts as to the fulfilment of specific agreements with counterparties, the agreements are postponed or cancelled. The limit for an exposure to a contractor is revised at least once a year.

The table below shows how the overall exposure is assessed for each type of acceptable agreement:

**Table 15: Agreements with counterparties**

Agreement	Instruments	Assessment of the overall exposure
Deposits placed with other banks	Deposits placed with banks Nostro accounts Repurchase agreements Withdrawn amount from a credit obligations	Nominal residual value
Contingent liabilities	Guarantees, letters of credit Not withdrawn amount from a credit obligations	Nominal withdrawn amount
Derivative transactions	Forward FX Transaction FX swap	Credit equivalence of the amount between the transaction date and value date and, at the time of maturity of the transaction, nominal value at the date of the transaction
Spot transactions	Cash transactions FX spot transactions	Nominal value on the date of the transaction; for FX spot transactions - additional credit equivalent between the transaction date and value date
Debt securities	Assets recognized as 'available for sale'	Market value

As of 31.12.2014, the distribution of the liquid assets of the Bank by counterparties is the following:

**Table 16: Liquid assets by counterparties**

By residual maturity	BNB	Banks licensed in EU countries	Banks licensed in USA	Bulgarian government (issued debt instruments)	Derivative positions	Total
At sight (nostro accounts)	143,612	135,173	2,946	-	-	281,730
up to 1 year	-	-	-	8,439	-	8,439
from 1 to 5 years	-	-	-	20,064	-	20,064
<b>Total receivables from counterparties</b>	<b>143,612</b>	<b>135,173</b>	<b>2,946</b>	<b>28,503</b>	<b>-</b>	<b>310,233</b>

The exposure of the Bank to counterparty risk is analysed and quantified on a monthly basis within the framework of the risk-bearing capacity calculations. They are weighted in terms of repayment period and credit rating of the counterparty, taking into account all exposures to banks, countries and supranational institutions. Stress tests are applied to assess sensitivity to impairment indicators for counterparty risk (i.e. reducing credit rating).

For the purposes of the capital adequacy calculation, when determining the exposure to counterparty risk and when defining the risk-weighted assets, the following agencies for external credit ratings are considered: Moody's, Standard & Poor's (S&P), and Fitch Ratings. Exposure classes as of 31.12.2014 for which credit ratings of these agencies are used, are: 'Central governments or central banks' and 'Institutions'.

#### 4.3. Capital instruments not included in a trading portfolio

ProCredit Bank does not hold a trading portfolio under Art. 94 of Regulation 575/2013. As of 31.12.2014, the Bank holds equity securities totalling BGN 947 thousand. These securities are classified as financial assets available for sale and reported at acquisition cost. They are presented mainly by shares in national and international payment operators. The securities are not traded on a regulated market and therefore their fair value cannot be determined reliably. The Bank recognizes income from them only insofar as a dividend is received from the accumulated net profits of the enterprise.

#### 4.4. Exposure classes by the standardised approach to credit risk assessment as per Regulation 575/2013.

To determine the credit risk for the risk-weighted assets ProCredit Bank applies the standardised approach as per Part Three, section II of Regulation 575/2013.

The tables below present information on the distribution of the risk exposures of the Bank in relation to the credit risk by exposure classes listed in Art. 112 of Regulation 575. The value of the exposures is presented after deduction of credit risk adjustments and before application of techniques for the mitigation of credit risk.

**Table 17: Amounts by exposure classes – total amount and average value**

<i>BGN thousands</i>	<i>Average value by quarters for 2014</i>	<i>31-12-2014</i>
<b>Exposure class as per the standardised approach</b>		
Central governments or central banks	159,267	172,115
Multilateral development banks	-	-
Institutions	102,003	138,220
Corporates	54,145	67,557
Retail exposures	556,911	565,796
Exposures secured by mortgages on immovable property	378,453	353,849
Exposures in default	23,648	21,092
Equity exposures	911	947
Other items	96,309	114,398
<b>Total amount of the risk positions</b>	<b>1,371,647</b>	<b>1,433,974</b>

**Table 18: Amounts by exposure classes – geographical distribution**

<i>BGN thousands</i>	31-12-2014				
<b>Exposure class as per the standardised approach</b>	<b>Republic of Bulgaria</b>	<b>Other countries of the EU</b>	<b>Other countries</b>	<b>Not applicable</b>	<b>Total</b>
Central governments or central banks	172,115	-	-	-	172,115
Multilateral development banks	-	-	-	-	-
Institutions	-	135,173	3,047	-	138,220
Corporates	67,557	-	-	-	67,557
Retail exposures	563,205	-	2,591	-	565,796
Exposures secured by mortgages on immovable property	353,849	-	-	-	353,849
Exposures in default	21,092	-	-	-	21,092
Equity exposures	695	252	-	-	947
Other items	-	-	-	114,398	114,398
<b>Total amount of the risk positions</b>	<b>1,178,513</b>	<b>135,425</b>	<b>5,638</b>	<b>114,398</b>	<b>1,433,974</b>

**Table 19: Amounts by exposure classes – distribution by significant business sectors**

<i>BGN thousands</i>	31-12-2014								
<b>Exposure class as per the standardised approach</b>	<b>Government</b>	<b>Activity of central bank or commercial banks</b>	<b>Trading</b>	<b>Agriculture</b>	<b>Production</b>	<b>Services</b>	<b>Other activities</b>	<b>Not applicable</b>	<b>Total</b>
Central governments or central banks	28,503	143,612	-	-	-	-	-	-	172,115
Multilateral development banks	-	-	-	-	-	-	-	-	-
Institutions	-	138,220	-	-	-	-	-	-	138,220
Corporates	-	-	13,108	8,212	20,097	7,746	18,394	-	67,557
<i>Incl. Exposures to SMEs</i>	-	-	7,891	8,213	5,968	2,263	8,651	-	32,986
Retail exposures	-	-	142,761	208,977	74,462	43,945	95,651	-	565,796
<i>Incl. Exposures to SMEs</i>	-	-	142,695	208,331	74,460	43,942	82,661	-	552,089
Exposures secured by mortgages on immovable property	-	-	113,683	33,667	66,913	42,438	97,148	-	353,849
<i>Incl. Exposures to SMEs</i>	-	-	86,908	29,079	53,276	30,768	48,745	-	248,776
Exposures in default	-	-	7,072	606	5,246	4,012	4,156	-	21,092
Equity exposures	-	-	-	-	-	947	-	-	947
Other items	-	-	-	-	-	-	-	114,398	114,398
<b>Total amount of the risk positions</b>	<b>28,503</b>	<b>281,832</b>	<b>276,624</b>	<b>251,462</b>	<b>166,718</b>	<b>99,088</b>	<b>215,349</b>	<b>114,398</b>	<b>1,433,974</b>

**Table 20: Amounts by exposure classes – distribution by residual maturity**

<i>BGN thousands</i>	<i>31-12-2014</i>				
<b>Exposure class as per the standardised approach</b>	<b>&lt;1 year</b>	<b>1-5 years</b>	<b>&gt;5 years</b>	<b>Not applicable</b>	<b>Total</b>
Central governments or central banks	152,179	19,936	-	-	<b>172,115</b>
Multilateral development banks	-	-	-	-	-
Institutions	138,220	-	-	-	<b>138,220</b>
Corporates	29,447	24,242	13,868	-	<b>67,557</b>
Retail exposures	222,926	281,333	61,537	-	<b>565,796</b>
Exposures secured by mortgages on immovable property	103,509	167,183	83,157	-	<b>353,849</b>
Exposures in default	-	-	21,092	-	<b>21,092</b>
Equity exposures	-	-	-	947	<b>947</b>
Other items	-	-	-	114,398	<b>114,398</b>
<b>Total amount of the risk positions</b>	<b>646,281</b>	<b>492,694</b>	<b>179,654</b>	<b>115,345</b>	<b>1,433,974</b>

**Table 21: Impaired and defaulted exposures. Credit risk adjustments**

<i>BGN thousands</i>	<i>31-12-2014</i>				
<b>Business sector</b>	<b>Impaired exposures</b>	<b>Defaulted exposures</b>	<b>Specific provisions for credit risk</b>	<b>General provisions for credit risk</b>	<b>Costs for provisions for impairment</b>
Trading	17,957	17,095	8,245	3,989	2,716
Agriculture	2,540	4,609	2,080	3,895	1,917
Production	12,241	8,481	4,274	2,076	1,846
Services	8,654	10,032	1,954	1,331	1,216
Constructions	12,979	6,994	2,008	609	480
Transportation	1,551	1,769	1,193	846	538
Hotels and restaurants	5,480	3,007	1,838	785	371
Households	593	1,414	509	707	246
<b>Total</b>	<b>61,995</b>	<b>53,401</b>	<b>22,101</b>	<b>14,238</b>	<b>9,330</b>

#### 4.5. Techniques for credit risk mitigation

Credit risk is the main risk faced by ProCredit Bank in its activities and the adequate collateralisation of the credit exposures helps to mitigate the risk. The collateral items are defined as assets pledged or mortgaged by the borrower to guarantee the credit exposure. In principle, The Bank accepts any type of collateral which is permitted by law and considered appropriate by the relevant credit committee. The Bank can provide financing guaranteed by collateral and/or guarantees. Collateral owned by related parties, partners and third parties is accepted.

The credit decision is based on assessment of the business and creditworthiness of the borrower. Apart from this, the Bank seeks to secure its receivables from clients with high-quality collateral. The choice of collateral is closely related to the credit risk assessment, which includes the financial state of the borrower, the term, the purpose of the loan and the method of repayment.

The collateral items are valued at fair market price, which represents the amount for which the property would change its owner, going from the seller to the buyer, both acting at their free will, without any pressure whatsoever and are well aware of the relevant circumstances. As a rule, real estate properties are appraised by applying at least two different methods. For

real estate properties whose fair market value is below EUR 150,000, only one method is applied.

For business clients – small and medium enterprises –the collateral assessments are updated as part of the annual monitoring of the business activity and the financial state. This process involves checking the legal aspects concerning the collateral and its current market price. In case a significant reduction in the price of the asset under assessment is established, or if there is a deviation from the procedures of the Bank related to the covering of the credit exposure, the case is referred to a credit committee to be resolved appropriately.

The types of collateral accepted by the Bank are:

- Deposits;
- Real estate (housing, administrative, commercial and industrial properties, hotels, regulated land properties, etc.);
- Inventory or materials;
- Vehicles;
- Receivables;
- Equipment;
- Livestock;
- Guarantees;
- Other.

To reduce credit risk, the following techniques (instruments) are applied when calculating the capital requirements for credit risk:

- Guarantees obtained from the European Investment Fund (EIF) on credit exposures, under the following programmes for lending to small and medium-sized enterprises:
  - First Loss Portfolio Guarantee Agreement - EIF guarantees to cover losses on loans under certain conditions in the agreement. The amount of the guarantee is EUR 10 million for the entire portfolio of EUR 40 million, with a maximum of 80% coverage for a single exposure. As of 31.12.2014 the remaining balance of loans granted under the programme is BGN 32 million.
  - Portfolio Risk Sharing Facility Agreement. In accordance with the Agreement, ProCredit Bank has to provide loans to small and medium enterprises totalling EUR 100 million by the end of 2015. EIF provides guarantees for half of the financed amount for an individual loan in this portfolio. As of 31.12.2014, the remaining balance of loans provided under the programme is BGN 106 million.
- Funded protection in the form of funds blocked in the account of the borrower or related persons. Upon recognition of funded protection for credit risk mitigation, a simplified method is used for financial collateral under Regulation 575.

The distribution of risk exposures according to class and risk weight before application of techniques for credit risk mitigation is as follows:

**Table 22: Risk exposures by class and applied risk weight before applying techniques for credit risk mitigation**

<i>BGN thousands</i>	31-12-2014							
	Risk weight (%)							
<b>Exposure class as per the standardised approach</b>	<b>0%</b>	<b>20%</b>	<b>35%</b>	<b>50%</b>	<b>75%</b>	<b>100%</b>	<b>150%</b>	<b>Total</b>
Central governments or central banks	163,756	-	-	8,359	-	-	-	<b>172,115</b>
Multilateral development banks	-	-	-	-	-	-	-	-
Institutions	-	138,119	-	-	-	101	-	<b>138,220</b>
Corporates	-	-	-	-	-	67,557	-	<b>67,557</b>
Retail exposures	-	-	-	-	565,796	-	-	<b>565,796</b>
Exposures secured by mortgages on immovable property	-	-	91,917	96,748	-	165,184	-	<b>353,849</b>
Exposures in default	-	-	-	-	-	13,457	7,635	<b>21,092</b>
Equity exposures	-	-	-	-	-	947	-	<b>947</b>
Other items	57,634	-	-	-	-	56,764	-	<b>114,398</b>
<b>Total amount of the risk positions</b>	<b>221,390</b>	<b>138,119</b>	<b>91,917</b>	<b>105,107</b>	<b>565,796</b>	<b>304,010</b>	<b>7,635</b>	<b>1,433,974</b>

The data in the above table are after deduction of credit risk adjustments (impairment loss provisions). Also, the exposures to SMEs included in the positions above are not multiplied by a factor of 0.7619, by which alleviation of capital requirements is obtained for exposures to SMEs under Regulation 575/2013.

The distribution of risk exposures according to class and risk weight after application of techniques for credit risk mitigation is as follows:

**Table 23: Risk exposures by class and applied risk weight before applying techniques for credit risk mitigation**

<i>BGN thousands</i>	31-12-2014							
	Risk weight (%)							
<b>Exposure class as per the standardised approach</b>	<b>0%</b>	<b>20%</b>	<b>35%</b>	<b>50%</b>	<b>75%</b>	<b>100%</b>	<b>150%</b>	<b>Total</b>
Central governments or central banks	163,756	-	-	8,359	-	-	-	<b>172,115</b>
Multilateral development banks	59,326	-	-	-	-	-	-	<b>59,326</b>
Institutions	-	138,119	-	-	2,591	101	-	<b>140,811</b>
Corporates	-	-	-	-	-	61,680	-	<b>61,680</b>
Retail exposures	-	-	-	-	523,648	-	-	<b>523,648</b>
Exposures secured by mortgages on immovable property	-	-	90,456	94,361	-	139,691	-	<b>324,508</b>
Exposures in default	-	-	-	-	-	13,435	7,635	<b>21,070</b>
Equity exposures	-	-	-	-	-	947	-	<b>947</b>
Other items	73,105	-	-	-	-	56,764	-	<b>129,869</b>
<b>Total amount of the risk positions</b>	<b>296,187</b>	<b>138,119</b>	<b>90,456</b>	<b>102,720</b>	<b>526,239</b>	<b>272,618</b>	<b>7,635</b>	<b>1,433,974</b>

## V. Market risk

ProCredit Bank adopts a conservative approach to market risk. The Bank does not hold a trading portfolio (of debt instruments, capital instruments or derivatives) with the aim of short-term resale and generating profit from market prices, this being a speculative activity, which is not in line with the business model and the management strategy of ProCredit Bank and the ProCredit group.

### 5.1. FX risk

FX risk is the risk of loss from changes in exchange rates. The main risk indicator which shows the disparities between the positions of the Bank in a certain foreign currency is the open currency position. Under the applicable rules and strategy, the currency positions are closed and are limited by conservative limits.

The impact of FX risk on the Bank is minimized by applying the following basic principles:

- FX positions for speculative purposes are not held.
- Derivative instruments are only used for the purpose of hedging, when closing positions in a certain currency is not possible. Permitted derivative instruments are FX forwards and swaps.
- FX operations relate to client servicing and are performed at market levels.
- In order to minimize currency risk, the following limits are set for open positions in foreign currency (except for EUR):

**Table 24: FX risk limits**

	Open currency position in individual currency (% of capital)	Total open foreign currency position (% of capital)
Reporting trigger	± 5%	7.5%
Limit		10%

ProCredit Bank operates with the following foreign currencies: USD (US dollar), EUR (euro), GBP (British pound) and CHF (Swiss franc). Due to the currency board and the pegging of the exchange rate of the lev to the euro, the Bank is not exposed to currency risk related to EUR.

### 5.2. Exposure to interest risk by positions which are not included in the trading portfolio

Interest rate risk is the risk of losses due to changes in market interest rates and arises from discrepancies between interest-sensitive assets and liabilities. ProCredit Bank does not seek to profit from speculation as regards to the level of interest rates. The Bank manages interest rate risk by limiting it to an acceptable size, seeking to maintain an adequate balance between interest-sensitive assets and liabilities to minimize the disparity between them. ProCredit Bank applies the group policy of ProCredit Holding to manage interest rate risk. The committees responsible for the ongoing monitoring and management of interest rate risk are the Assets and Liabilities Management Committee and the General Risk Assessment

Committee. The management assesses the level of interest rate risk in the Bank's portfolio as low.

Interest rate risk is measured separately for each of the main operating currencies. The measurement of the degree of exposure to interest rate risk is based on the following basic techniques:

- Analysis of the discrepancies between interest-sensitive assets and liabilities by time buckets;
- Maturity gap analysis of assets and liabilities;
- Sensitivity of the present value of cash flows in the buckets to different scenarios of change in interest rates;
- Stress-test scenarios for unforeseen shocks in interest rates associated with changes in the yield curve.

The instruments with fixed interest rates are divided into time buckets according to their residual maturity. Assets and liabilities with variable income are distributed by time buckets to the residual term until the next reassessment date. No interest is accrued on current accounts, so they are regarded as not interest-sensitive liabilities and are not included in the distribution by time buckets.

The main indicators applied in the management of interest rate risk are as follows:

- **Effect on the economic value.** This indicator measures the potential loss as regards to the net present value of assets and liabilities which the Bank would suffer in case of a very unfavourable change (a shock) in market interest rates.
- **Effect on current yield.** This indicator measures the potential impact of a short-term change in interest rates on the net interest income within the time horizons of 3 months and 12 months.

## VI. Liquidity and funding risk

Liquidity risk and funding risk are related to the ability of the Bank to meet its financial obligations in full and on time in the short- and long-term perspective.

The framework for liquidity risk management has been approved by the Management Board and is based on the Group Liquidity Risk Management Policy. The process involves various functional units of the Bank - Finance Department, Risk Management Department, Treasury Unit and ALCO.

Liquidity risk is the risk that the Bank would not be able to meet its current and future obligations in full or on time. The risk is limited by the structure of the principal assets and liabilities of the Bank - a diversified loan portfolio, in which there is a regular cash inflow in the form of payment of principal and interest and deposits from targeted clients - depositors and business clients with whom long-term relationships have been established.

The instruments which are applied to manage liquidity risk also include:

- **Analysis of the discrepancies with maturity buckets.** A comparison of the amount of the assets available to cover liabilities in a given time bucket.
- **Group liquidity reserve.** Maintained at the ProCredit Group level. In case of need it can be directed to the institution concerned.
- **Expected cash flows.** Analysis of expected cash flows for a period of six months is submitted on the regular meetings of the ALCO.
- **Early warning system.** The system is aimed at timely identification of internal or external events that may have a negative effect on the liquidity risk of the Bank. It consists of various internal and external reporting indicators and triggers by monitoring potential events which become the basis for taking the envisaged actions.

In addition, the Bank maintains at all times the available liquid assets that provide coverage of at least 20% of the liabilities in deposits from customers. The average ratio in 2014 amounted to 32.9%.

Funding risk is associated with the danger of not being provided with additional funding or that it can only be possible at a significantly increased price. Again, this risk is reduced by the fact that the main source of funding for lending operations consists of deposits from clients, which are complemented by available long-term financing from international financial institutions. At the same time, the use of funding from the interbank market is highly limited.

The Bank also monitors the concentration of attracted funds from clients. The amount of the 10 largest client deposit exposures must not exceed 20% of the total amount of funds attracted from customers (at the end of 2014 the value of this coefficient is 3.5%).

The funding risk is covered by the capital buffer within the calculation of risk-bearing capacity. Liquidity risk is not taken into account when calculating the risk-bearing capacity, because such risk cannot be reduced via capital.

## VII. Exposure to operational risk

ProCredit Bank defines operational risk as the risk of losses resulting from inadequate or poor internal processes, problems with people and systems or due to external events. Operational risk can occur as a result of inadequate information systems, technological errors, breaches in internal control, fraud, contingencies and other issues of an operational nature, as a result of which the Bank may suffer unexpected losses. It also includes legal and reputational risk.

The Bank continually assesses and analyses all key processes in order to determine the levels of operational risk and the ways to reduce and prevent the occurrence of operational risk events. In the procedures and internal rules of the Bank the banking processes specify how to minimize or avoid operational risk and which management units in Head Office should be immediately alerted upon the occurrence of an event. The internal procedures of the Bank describe all corrective measures that should be taken at the occurrence of an event, and the preventive measures that should enter into force in order to avoid such events. The framework for operational risk management is approved by the Management Board. A system is developed for conducting regular training of staff, which is aimed at improving the prevention and management of operational risk events.

The Bank keeps a register of data collected on all operational risk events that have occurred on a monthly basis, regardless of whether they result in financial loss or not. For the purposes of operational risk analysis, a materiality threshold of EUR 100 for operating losses from an event is defined. In order to take preventive measures to minimize the exposure to operational risk, cases that carry a potential risk but at the time of their registration have not led to real financial loss are also collected.

Once a year, a review of the adequacy of insurances and their conditions is performed. The Bank has covered all essential insurance events which it could be exposed to.

In 2014, ProCredit Bank used the standardised approach to quantify operational risk.

### VIII. Remuneration policy and practice

The process of determining the remuneration of the Bank personnel is regulated by Rules for Remuneration of the Personnel and Remuneration Policy of Senior Positions as per Art. 2 of Ordinance No. 4 of BNB (these positions are: senior management, employees whose work is related to risk-taking; staff engaged in control functions - or staff whose actions have a significant impact on the risk profile of the institution). The Bank has a Human Resources Committee which monitors changes in the situation on the labour market in the country and remuneration levels in and outside the Bank, reviews salaries and makes decisions on issues concerning current or potential employees of the Bank. The members of the Human Resources Committee are: the Chairman of the Supervisory Board, three members of the Management Board and a Branch Manager. Depending on the nature of the topics of the meetings, the Committee may invite other participants. The Human Resources Committee holds monthly meetings.

Remunerations are determined according to the position held, its hierarchical relationship to other positions and the level of performance of tasks and responsibilities. The system has clear and objective rules for determining the individual salary of the employees. When defining the ratio of salary levels between positions, best practices and experience of all ProCredit banks within the group and levels of responsibility and risk that are borne by individual positions are taken into account.

The individual employee salary at the Bank is determined by quantitative and qualitative criteria. Quantitative criteria are related to the position occupied and the qualitative criteria are universal for all positions. Qualitative criteria are: contribution to the business development of the Bank, managerial (organizational) competence, autonomy in the performance of assigned tasks, possession of specific knowledge and skills required in the performance of assignments, communication with counterparties of the Bank.

Variable remuneration (including performance-related remuneration) is not applied and excessive risk-taking is not encouraged. For this reason, the employees of the Bank are not paid additional remuneration which is related to quantifications of work performance. Remuneration in shares or share-linked instruments is not applied either.

The table below shows quantitative information related to remuneration by types of activities for 2014:

**Table 25: Remuneration by activities**

<i>BGN thousands</i>	<i>For the period 01.01-31.12.2014</i>
<b>Type of activity</b>	<b>Total remuneration</b>
<b>Head Office</b>	
Senior and middle management	1,874
Other expert positions	9,061
<b>Branch network</b>	
Branch network middle management	1,892
Branch network - Other expert positions	12,306
<b>Total</b>	<b>25,133</b>

The summarised quantitative information on remuneration, divided into senior management and members of staff whose actions have a material impact on the risk profile of the Bank is as follows:

**Table 26: Remuneration of the senior management and the members of staff whose actions have a material impact on the risk profile of the institution**

BGN thousands		For the period 01.01-31.12.2014	
Senior management		Members of staff whose actions have a material impact on the risk profile of the institution	
Fixed remuneration		Fixed remuneration	
Number of recipients	Amount	Number of recipients	Amount
5	542	142	5,719

Information on remuneration on recruitment and dismissal is as follows:

**Table 27: Remuneration on recruitment and dismissal**

BGN thousands		For the period 01.01-31.12.2014					
Senior management				Members of staff whose actions have a material impact on the risk profile of the institution			
Remuneration on recruitment		Compensations for termination of employment		Remuneration on recruitment		Compensations for termination of employment	
Number	Amount	Number	Amount	Number	Amount	Number	Amount
-	-	-	-	-	-	24	311

In 2014, the highest amount of such compensation for one person was BGN 31 thousand.